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No. 85-863

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

LUBRIZOL ENTERPRISES, INC.,
Petitioner,

v.

ROBERT A. CANFIELD, BANKRUPTCY TRUSTEE FOR RICHMOND METAL FINISHERS, INC.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

INTRODUCTION

Petitioner Lubrizol Enterprises, Inc. ("Lubrizol") submits this reply brief to correct the misstatement of the history of this case contained in Respondent's Brief in Opposition, to clarify the nature of the interests that would be jeopardized if the decision below is left uncorrected, and to emphasize the importance of this Court deciding this case in view of the blind adherence which the decision below has already received even where it is not the controlling law.

ARGUMENT

I. Lubrizol Is Not Raising a New Issue in This Court.

The central issue in this case is and has been whether a bankruptcy debtor in possession or trustee (collectively "DIP"), can, as a result of its rejection of a contract under § 365 of the Bankruptcy Code (the "Code"), deprive a party to such contract of the benefit of the partial performance of the contract rendered by the debtor prior to its bankruptcy filing. The focus of this case, then, is and has been Lubrizol's continuing rights in unpatented technological information (the "Technology") which was disclosed by Richmond Metal Finishers, Inc. ("RMF") to Lubrizol more than a year prior to RMF's bankruptcy filing, pursuant to the agreement which RMF has sought to reject in this case (the "Agreement").

Respondent argues that Lubrizol is raising for the first time the question whether a pre-petition transfer of the Technology to Lubrizol occurred under the Agreement. This contention is inexplicable, since the Fourth Circuit stated that it disagreed with the District Court's conclusion that the transfer of the Technology was "effectively a completed sale of property." Pet. App. at 5a-6a n.*; 756 F.2d at 1046 n.*. The District Court also addressed this issue. *See* Pet. App. at 12a; 38 Bankr. at 342. Obviously, an issue addressed by both the District Court and the Court of Appeals, and central to the disposition of the matter by each court, is not newly raised in the present petition.

In further support of his claim that Lubrizol did not previously argue that a completed transfer had occurred under the Agreement, Respondent argues that Lubrizol conceded below that the Agreement was executory.[1] This

[1] Lubrizol made that concession in its Petition for Rehearing to the court below solely for purposes of argument in that petition. *See* Petition for Rehearing and Suggestion of Rehearing in Banc

is a *non sequitur*. Implicit in this argument is the obviously incorrect assumption that no transfer could be complete under a contract which is still executory. This was the erroneous premise underlying the conclusion of the Fourth Circuit that Lubrizol was seeking specific performance, when in reality Lubrizol simply sought to protect itself against rescission. This is the fallacy that this Court should correct to prevent § 365 from being widely used to achieve an end never intended by Congress.

Under the prevailing understanding of the term "executory" as used in § 365, a contract need not be wholly unperformed to be an "executory contract" subject to rejection. All that is required is that "performance remains due to some extent on both sides." *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 522 n.6 (1984). Thus it is quite possible to have a contract under which a transfer has been completed, but sufficient executory obligations remain to render the contract executory for the purposes of § 365.

The Agreement here is such a contract; an initial transfer occurred, but contingent performance obligations remained on both sides. *See* Pet. at 3. Any sales agreement with mutual covenants surviving the transfer of property is an executory contract under these criteria. *See e.g., In re Smith Jones, Inc.*, 26 Bankr. 289 (Bankr. D. Minn. 1982).

It is precisely because such executory obligations can, and often do, co-exist with completed transfers of property that this Court should grant the petition in this case. The court below has held that the existence of executory obligations, even if contingent, together with a DIP's

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at 3. Likewise, in its Petition for Certiorari Lubrizol has not raised the issues of proper definition of "executory", nor whether the Agreement is executory. *See* Pet. at 9, n.7.

"business judgment" that rejection is beneficial, is a sufficient basis for rescission of the pre-bankruptcy property transfer. Such a result is both unprecedented and clearly inappropriate.

II. A Completed Transfer of Property Occurred Under the Agreement for which § 365 Does Not Provide a Right of Rescission.

Respondent attempts to avoid the fundamental question raised in Lubrizol's Petition: Can § 365 be used as the basis for divesting property transferred by the debtor prior to its bankruptcy filing? Respondent fails to meet the contention that such divestiture is not proper under § 365.

Instead, Respondent contends in his brief that RMF had not transferred property to Lubrizol, arguing that the Agreement is more like a lease. Br. in Opp. at 2-3. Yet RMF did not dispute in the courts below, Pet. App. at 30a; 34 Bankr. at 523, and does not dispute here, Br. in Opp. at 1, that it carried out its obligations under the Agreement to disclose the Technology to Lubrizol. Furthermore, under the Agreement, Lubrizol's right to possess the disclosed Technology never ends. *See* Agreement Article XIII(6), Pet. App. at 63a (obligations of disclosure and confidentiality survive any termination of Agreement). Under these circumstances, the analogy to a lease is flawed. *See* Pet. at 6 n. 5; *see also* Nimmer, The Law of Computer Technology ¶ 5.02[3] (1985) (conveyance of a trade secret is not mere license).

In fact, this transfer is neither lease nor sale, but is a transfer of rights, sui generis, governed by state contract and trade secret law. *See Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979) (state contract law relative to trade secrets is not preempted by federal patent law); *Kewanee Oil Co. v. Bicron Corp.* 416 U.S. 470 (1974) (state trade secret law is not preempted by federal patent law). Under such law, once such secret

information is disclosed without restriction or limitation, a party lawfully possessing the information may exploit it in perpetuity. *See Ruckelshaus v. Monsanto Co.*, 104 S. Ct. 2862, 2873 (1984).

Rejection of the Agreement by RMF would place Lubrizol effectively in the same position as one to whom disclosure was made without restriction. This is necessarily the case because the only restrictions are embodied in the Agreement on which neither the Trustee nor RMF can rely after rejection. Respondent is urging that § 365 of the Bankruptcy Code provides a means for the DIP to recapture what it has disclosed. This would amount to an unwarranted injunction against Lubrizol forbidding it from using the Technology when there exists no basis under either the Code or under state trade secret law supporting such relief.

Both Respondent and the courts below have overlooked the clear import of the Code: This is to treat rejection under § 365 as a breach of contract by the DIP and to apply non-bankruptcy law to ascertain the legal consequences of the breach, making unavailable, however, specific performance. 11 U.S.C. §§ 365(g), 502(g). The Code does not go any further. The court below has construed § 365 to provide remedies to the DIP of rescission and injunction which neither the statute, its legislative history nor sound public policy permits.

III. The Question Presented in This Case Has Not Been Previously Decided by This Court and Should Be Decided to Avoid Significant and Unnecessary Damage to Businesses in the United States.

Respondent's statement that "the subject of executory contracts . . . has previously been addressed by this Court," citing *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513 (1984), is accurate but hardly significant. *Bildisco* concerned the characterization of collective bargaining agreements as executory contracts and the combined

effect of national labor policy and the Bankruptcy Code. It did not address the question raised here concerning the *effect* of a determination that a contract is executory on the DIP's pre-petition performance of the contract. Nowhere in *Bildisco* was it suggested that employees must return to the bankrupt employer wages which they received prior to Bildisco's filing. Neither *Bildisco* nor any other decision of this Court has considered whether § 365(g) of the Code authorizes the bankruptcy court to order rescission of a contract divesting the non-debtor of the right to use property it had acquired under the contract prior to the bankruptcy filing.

In urging the Court to deny Lubrizol's petition, Respondent explicitly concedes that licensors and licensees will have to change the way they do business with one another if the decision below is permitted to stand. Br. in Opp. at 4-5. Respondent proposes that to avoid the new risks created by the decision below, inventors of new technology "will have to sell technological advancements to developers" of that technology. *Id.* This "solution" demonstrates the dilemma that the decision below creates for those seeking funding of new technological development. A party without sufficient funds to finance the full development of his idea would be forced either to abandon the development or to give up any continuing rights to his technology. In effect, the decision makes it impossible for the weaker party to license—he can only sell the fruits of his labor thus terminating any further or continuing interest in it. Ironically, Respondent argues for precisely the solution which was least acceptable to RMF when it was operating.

Trade secret law, which Congress and this Court have wisely chosen not to disturb, and which the court below ignored, exists to avoid this dilemma.

> Trade secret law promotes the sharing of knowledge, and the efficient operation of industry; it permits the

> individual inventor to reap the rewards of his labor by contracting with a company large enough to develop and exploit it. Congress, by its silence over these many years, has seen the wisdom of allowing the States to enforce trade secret protection.

Kewanee Oil Co. v. Bicron Corp., 416 U.S. at 493. Congress surely did not intend that the bankruptcy laws should reverse this view and create disincentives for technology development and sharing.

IV. The Decision Below Has and Will Mislead Bankruptcy Courts By Masking the Subtle Issues Relating To Intellectual Property.

The unquestioning acceptance of the Fourth Circuit's misconstruction of § 365 which is apt to occur in many bankruptcy courts is exemplified by the recent decision in *In re Chipwich, Inc.*, 54 Bankr. 427 (Bankr. S.D.N.Y. 1985). In *Chipwich* the court quoted at length from the opinion below and held that the licensee of a trademark is deprived of all rights to that trademark when the licensor rejects the license under § 365. 54 Bankr. at 431. While the *Chipwich* bankruptcy court's conclusion may or may not be correct, it is clear that that court, following the lead of the Fourth Circuit, did not engage in the necessary analyses of (1) the subtle but crucial distinctions between various kinds of intellectual property, (2) the effect under applicable non-bankruptcy law of a breach of the contract involved, or (3) the full effect of contract rejection under § 365.

Clear distinctions exist between intellectual property protected under patent, copyright, or trademark law and that protected under trade secret law particularly in the area of disclosure. *See generally*, Nimmer, The Law of Computer Technology (1985). For instance, patent law requires disclosure. 35 U.S.C. § 112 (1982). In contrast, "[i]f an individual discloses his trade secret to others who

are under no obligation to protect the confidentiality of the information, or otherwise publicly discloses the secret, his property right is extinguished." *Ruckelshaus v. Monsanto Co.*, 104 S. Ct. at 2873.

The court below purported to adopt the definition of "executory contract" set forth in Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973). Pet. App. at 3a; 756 F.2d at 1045. Explicit in that definition is the conclusion that the DIP's rejection excuses the non-debtor's performance of the rejected contract. Thus, the ultimate irony of the position taken by RMF in these proceedings is that, under a correct analysis of the law of trade secrets, rejection relieves Lubrizol of its duty to maintain confidentiality and destroys the very proprietary right which RMF would seek to market elsewhere for new consideration.

The court below has construed § 365 without evidencing an understanding of these distinctions, and the *Chipwich* court adopted that construction again without any analysis of the nature of the property interests being affected. Until the decision below is corrected, its erroneous construction of § 365 will limit the options available to parties entering into new contracts and will cause the loss of property of parties whose only fault was doing business with "potential bankrupts." Further, it may cause DIPs to take action—contract rejection releasing the non-debtor of its obligation to maintain the confidentiality of trade secrets—which destroy the very property interest which they seek to exploit.

CONCLUSION

The decision below is the result of a significant misunderstanding about the meaning of contract rejection in bankruptcy. This Court should promptly make it clear that contract rejection under § 365(a) is nothing more than a material breach of the contract. The consequences which flow from that breach in bankruptcy are only different from those which accompany a contract breach outside bankruptcy in the limitation of remedies available to the non-breaching party. Nothing in the Code creates remedies in favor of the breaching party.

For the reasons stated, a writ of certiorari should be granted.

Respectfully submitted,

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